Tasking trustees with transfers

– what trustees need to know about transfers from defined benefit occupational pension schemes

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The introduction of the pension freedoms in April 2015 gave individuals aged 55 and over greater choice about how they access their defined contribution (DC) benefits, including taking their benefits as a lump sum. Since then there has understandably been an increase in the number of transfers from occupational pension schemes being taken. As a defined benefit (DB) pension may in many cases be a very valuable benefit, and transfers are usually irreversible, there have been various protections put in place to make sure that members who decide to transfer their DB benefits to a DC arrangement to flexibly access those benefits are fully aware of the decision they are making, and have some protection from the scammers trying to access their hard-earned pension savings.

The starter for £30,000

The starting point is that, if a member has ‘safeguarded’ benefits (such as DB to you and me) which exceed £30,000, they MUST obtain appropriate independent advice before they are able to transfer those benefits to a DC arrangement, or convert them into flexible benefits.

What's a trustee to do?

Trustees need to be aware of when this requirement for appropriate independent advice is triggered. The relevant measure for the £30,000 threshold is the cash equivalent transfer value (CETV). How to calculate the CETV is set out in legislation, but the important point is that it is typically based on a best estimate of the expected cost of providing the member's benefits in a scheme. While the factors used to calculate a scheme's CETV can change depending on a scheme's funding position, trustees must not try to circumvent the advice requirement by trying to set factors that will not trigger the requirement for many members.

If the advice requirement is triggered, trustees must inform the member and then check that the member goes on to take that appropriate independent advice from an authorised independent adviser. In reality this means that trustees have to obtain written confirmation from the independent adviser that the advice was obtained (although they do not need to actually see the advice) and they must check that the firm the adviser works for has permission from the Financial Conduct Authority (FCA) to provide advice on pension transfers, by checking the FCA register. There are also lots of stringent rules about what the adviser has to cover to ensure that the member understands the decision being made – a comparison using generic assumptions for hypothetical receiving schemes is not sufficient.

This adds an extra layer of administration for trustees which, if not undertaken, could result in a fine on the trustees (of up to £5,000 for individuals and £50,000 for corporates), but will not automatically invalidate the transfer.

Even if the advice requirement is not triggered, trustees must still remind members of the information available on transfers from the Pensions Regulator, the Pensions Advisory Service and the FCA, and recommend that members take advice before proceeding with any transfer.

Protections paradise?

The advice requirement was introduced to ensure that members receive appropriate advice, and make decisions based on fully understanding the financial implications of any proposed transfer from a DB occupational pension scheme to a DC arrangement/when flexibly accessing benefits. However, there are still loopholes in the protection. For example, what about members with benefits of £30,000 or less? Also, members may be slow to see the beauty of this protection, as they are generally expected to fund the (often not insignificant) cost of the advice (unless the transfer is led by the employer) and, at the moment at least, do not have the same ability of members with DC benefits to withdraw up to £1,500 over their lifetime to pay for retirement advice.

Job all done?

Whether a member understands and wants to make a transfer is not the only concern that needs to be on trustees' minds. There is also the need to watch out for pension scams which promote the ability of members to take their benefits before they should, and could leave members without any savings at all. A pension scam occurs when a member transfers his/her benefits into a new scheme which may allow the member access to his/her pension savings before the normal minimum pension age (typically age 55 where the member is not in serious ill health). Organisations offering these opportunities frequently refer to them as pension loans, or offer cash incentives to members to sign over their pension benefits.

The downside for members is that HM Revenue and Customs (HMRC) will consider this an unauthorised payment which is subject to a tax charge, starting at 55% of the amount accessed, and potentially going up to 70% if the member does not inform HMRC. Once the member takes account of charges this may mean that (s)he loses most, if not all, the pension benefits.

To minimise this risk, trustees are expected to carry out due diligence on a receiving scheme to ensure that it is a legitimate scheme, as well as willing and able to accept the transfer. The Pensions Liberation Industry Group has published a code of good practice which sets out in detail the due diligence process that trustees should undertake.

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More haste, less speed

While trustees are required to make transfers from DB occupational pension schemes within six months of an initial request, the regulator has recognised that trustees may need more time to carry out the increased due diligence. Therefore trustees can now apply to the regulator for an extension, although such an extension will only be granted in limited circumstances. For example, when trustees have not been provided with information they reasonably require to carry out the transfer.

The application for the extension must be made within the six-month period, and should indicate the additional time required to effect the transfer, as well as the reasons the extension is needed.
If trustees suspect a pension scam, they should consider making such an application as soon as ▶

the due diligence raises concerns, and they consider that the criteria to request an extension are met.

One more for the list

If a member wants to transfer his/her pension benefits to an overseas pension scheme, there are even more checks for trustees to undertake. Trustees must be satisfied that the receiving scheme is a qualifying recognised overseas pension scheme (QROPS). This creates difficulties as, in practice, there is no means of confirming that a receiving scheme is a QROPS, and presence on the HMRC's list is not a guarantee that the scheme is a QROPS. A transfer to a scheme which is not a QROPS will be an unauthorised payment which will be subject to a tax charge. It may be that trustees will want to seek a warranty from the receiving scheme that it is a QROPS, but not all schemes will give this.

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In addition, a new 25% tax charge to legitimate transfers has been introduced. This will apply to any requests to transfer to a QROPS on or after 9 March 2017, unless (very broadly) the member and QROPS are both in the European Economic Area (for tax purposes) or the member is an employee of a sponsoring/participating employer of the QROPS. If the tax charge applies, trustees must deduct it from the member's fund before making the transfer, and should report and account for the tax.

It is also worth bearing in mind that, if a member transfers to a QROPS, (s)he must still take appropriate independent advice. This may create difficulties because FCA advisers may not have expertise in the relevant overseas jurisdiction. As a result, the Government has consulted on whether the advice requirement should be removed or adapted for overseas pension transfers. In the meantime, members considering a transfer overseas are likely to need to pay for two sets of advice – one from an FCA-regulated adviser to satisfy the advice requirement, and the second from an overseas adviser on the suitability and local tax implications of the proposed scheme.

Silver lining

On the face of it, it can seem like transfers out of DB occupational pension schemes put trustees between a rock and a hard place. There is no denying that transfers out of a DB occupational pension scheme are a difficult balancing act for trustees.

On the one hand, if a statutory transfer does not meet statutory requirements, trustees may not get a valid statutory discharge, so the member may still be able to claim benefits from the scheme; if the payment is unauthorised, it is likely to trigger tax charges for the scheme and the member; and if the member's savings are lost, there's the risk of a future complaint.

On the other hand, if a member has a statutory right to transfer, and the receiving scheme meets all the requirements but trustees still block the transfer, for example because they think the scheme is just not legitimate, there is a risk of fines and (again) member complaints.

Having said that, the Pensions Ombudsman seems, in its recent decisions, to be recognising the difficult position that trustees are in. While very fact-specific, recent decisions have seen a scheme administrator being discharged from liability to pay a scheme sanction charge arising in connection with a pensions liberation scheme, because the administrator reasonably believed that no unauthorised payment was being made, and that it was reasonable for an administrator to refuse to process a transfer in 2013 as it had legitimate concerns about the receiving scheme, based on the knowledge it had at the time (although, as things have moved on since 2013, the Pensions Ombudsman did say that the administrator should review its decision and see if the member still wants to proceed with the transfer).

The moral of the story…

is that trustees should ensure that they have robust processes in place to deal with transfers out of DB occupational pension schemes (or any scheme). They need to work with their administrators to ensure that all the practical requirements are being met, and should document their processes as evidence that they are acting in accordance with their duties as trustees, walking the always fine line between protecting and nurturing members and letting them fly (or transfer) free.